IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1544

JOYCE BEVERAGES, INC., JOHN M. JOYCE and WILLIAM J. COLLIER,

Petitioners,

vs.

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE MCMANUS, PAUL MCMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

MICHAEL LESCH
SHEA GOULD CLIMENKO & CASEY
330 Madison Avenue
New York, New York 10017

Attorneys for Joyce Beverages, Inc., John M. Joyce and William J. Collier

Of Counsel
MICHAEL LESCH,
SANFORD A. BELL.

Table of Authorities

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-1544

JOYCE BEVERAGES, INC., JOHN M. JOYCE
and WILLIAM J. COLLIER,

Petitioners,

vs.

WILLIAM J. JOYCE, BERNICE RILEY JOYCE, MARY JOYCE HAMMOND, WILLIAM J. JOYCE, JR., DOROTHY ANN JOYCE, CATHERINE JOYCE MCMANUS, PAUL MCMANUS, JILL JOYCE KASSELMAN and JUDITH JOYCE LANG,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY BRIEF

Petitioners submit this reply brief in further support of their petition for a writ of certiorari and in reply to arguments raised in respondents' brief in opposition.

Respondents concede that the standard of materiality applied by the Second Circuit below is one which differs from (and, in fact, flatly contravenes) the standard established by this Court in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976) (Resp. Br. 6). They attempt to

justify this obvious deviation, as one which is somehow required by "the procedural posture of this case" (Resp. Br. 6).

We do not, however, perceive the slightest indication in *TSC* that this Court intended the standard of materiality under the federal securities laws to be subject to a sliding scale or variable definition dependent on the stage of the litigation.

The standard of materiality which the majority below ultimately relied on, and which respondents argue is correct, focuses on facts which a stockholder "could" conceivably have considered important under some unidentified hypothetical set of circumstances and thus constitutes a formulation "too suggestive of mere possibility, however unlikely" which this Court repudiated in *TSC* (426 U.S. at 449). The Second Circuit decision is grounded on the following speculative conclusion:

> "The statement about the potential availability of Rule 144 *could* have misled the reasonable shareholder into thinking that it was, in fact, available to him. Similarly, the discussion of the loss of preemptive rights and the discontinuance of cumulative voting as a result of the changeover to Delaware law, *could* have misled him into thinking that the changeover did not otherwise affect his rights." (emphasis added.)

The notion of materiality applied by the Court below virtually forecloses pre-trial dismissal of any claim based on alleged misstatements or omissions, no matter how trivial the claim or how remote the likelihood that the shareholder was misled. If not overturned, the majority opinion below will signal to potential litigants that the mere allegation of "material" misstatements or omissions will suffice to preserve an action for trial. The threat of litigation of such trivial and remote claims will cause corporate management to "bury" stockholders with the very "avalanche[s] of trivial information" which this Court held in *TSC* would subvert the informed decision-making the securities laws are designed to foster.

Respondents seek to justify the loose standard applied by the Second Circuit in this case on the ground that *Conley* v. *Gibson,* 355 U.S. 41 (1957), "held that a complaint will not be dismissed until it appears to a certainty that plaintiff is not entitled to relief under any state of facts which *could* be proven in support of the claim" (Resp. Br. 7, emphasis added). Such a result is certainly not required by this Court's decision in *Conley.*

The *Conley* case merely held that the Rules of Civil Procedure generally permit simplified pleading. However, it is well established that allegations under Rule 10b-5, 17 C.F.R. § 240.10b-5, must comply with the requirements as to particularity of Rule 9(b), Fed. R. Civ. P. *See, e.g. Segal* v. *Gordon,* 467 F.2d 602, 607 (2d Cir. 1972).

And, it is clear that the *TSC* decision in no way rules out the summary disposition of questions of materiality as a matter of law in an appropriate case (426 U.S. at 450). Indeed, in *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977), this Court, citing *TSC,* upheld the dismissal of a complaint under Section 10(b) of the Securities and Exchange Act and Rule 10b-5 on the ground, among others, that the "failure to give advance notice was not a material nondisclosure within the meaning of the statute or the Rule" (430 U.S. at 474, n.14).

The several post-*TSC* decisions which respondent cite in support of their contention that allegations of material misstatements and omissions under the securities laws may not be tested prior to trial, simply do not support their position (Resp. Br. 7). Indeed, *Alton Box Board Co.* v. *Goldman, Sachs & Co.,* 560 F.2d 916 (8th Cir. 1977), the

only appellate decision and most recent decision cited by respondents in this regard, makes it clear that issues of materiality may in appropriate cases be resolved as a matter of law. Thus, in *Alton Box,* the Fourth Circuit stated:

> "We come then to the second question: whether this court can say that the undisclosed facts fail to constitute *as a matter of law,* facts which a reasonable investor would consider important in making the decision to purchase the notes in question. This depends, of course, upon the circumstances of the case." (560 F.2d at 920; emphasis in original.)

Respondents' argument is also refuted by the Second Circuit's opinion below which, even while applying the wrong standard of materiality, explicitly affirmed the district court's dismissal of one of respondents' three claims (set forth in ¶¶ 7, 8, 9 10(a) of the complaint, 20a-21a) on the ground that the alleged misrepresentation was not material *as a matter of law.*

The danger of permitting a "could" standard of materiality as applied by the Second Circuit below rather than the "would" standard established by this Court's *TSC* decision is dramatically illustrated by certain concessions respondents make in their opposing brief. Respondents no longer claim that petitioners' statements regarding Rule 144 were misleading but now, in light of the fact that petitioners have pointed out to the Court that the documents annexed to and forming part of respondents' own complaint plainly refute such an assertion (see Pet. for Cert., pp. 5-7), concede that such statements were at most "ambiguous" (Resp. Br. 3). Mere ambiguities, of course, do not amount to misstatements or omissions of facts which "would have assumed actual significance in the deliberations of the reasonable shareholders" and have never been held to be the basis for claims under the federal securities laws.

However, if the "could" standard of materiality applied by the Second Circuit below is permitted to stand, as respondents correctly point out, any allegation of an ambiguity in a disclosure document will now constitute a claim which cannot be disposed of without a trial. Thus, the sliding standard of materiality applied by the Second Circuit below, unless overturned, will result in an unwarranted and ill-conceived expansion of the federal securities laws.

Respondents also concede that petitioners had no duty to make an exhaustive disclosure of the differences between Delaware and Illinois corporation law (Resp. Br. 8-9). They persist, however, in contending that once petitioners elected in an Information Statement to disclose certain significant differences between Delaware and Illinois corporation law relating to newly-issued stock (which indeed promotes the informed decision-making which the securities laws seek to foster), they somehow become duty-bound to provide an exhaustive comparison of all differing provisions between the two laws no matter how insignificant or how remote from any facts alleged in this case.

Respondents' presentation of the disclosed and "undisclosed" differences (Resp. Br. 9) itself demonstrates the absurdity of respondents' position. For example, it *was* clearly important that shareholders voting on the proposed exchange be informed that minority representation could be entirely eliminated by Delaware law (which does not require cumulative voting) and that under Delaware law their dividends could be eliminated in the discretion of the Board of Directors. By contrast, it was wholly inconsequential whether a six month vacancy on the Board of Directors could be filled by the Board or by the shareholders where, as here, plaintiffs occupied a minority position as both board members and shareholders.

Thus, respondents' own presentation (Resp. Br., 9) clearly shows that petitioners set forth in the Information Statement the significant effects upon stockholders' rights resulting from a change from Illinois to Delaware incorporation and that the omitted differences were wholly insignificant. Indeed, respondents do not even pretend that any of the "undisclosed" differences between Illinois and Delaware law were of any significance or attempt to set forth any facts which "could be proven" in support of their claim as alleged in the complaint which would show that the omissions were, in fact, material.

In essence, respondents have sought to rationalize the Second Circuit's decision on the theory that concededly important information must be excluded from disclosure unless a whole host of remotely related insignificant information is also disclosed, stating (Resp. Br., 8-9):

> "Had the Information Statement done nothing more than inform the shareholders that the new holding company JBI, was to be incorporated under the laws of Delaware rather than Illinois where all of the operative companies were incorporated, there would be no claim."

Such a rule will present conscientious corporate managers with the choice of total nondisclosure or exhaustive disclosure with no permissible middle ground. To attempt to avoid frivolous litigation, the corporate managers will inevitably choose to set loose the "avalanche[s] of trival information" which this Court in *TSC* explicitly sought to avoid.

CONCLUSION

For all the reasons urged on behalf of petitioners, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

MICHAEL LESCH
SHEA GOULD CLIMENKO & CASEY
330 Madison Avenue
New York, New York 10017
Attorneys for Joyce Beverages, Inc., John M. Joyce and William J. Collier

Of Counsel

MICHAEL LESCH,
SANFORD A. BELL.